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INTERNATIONAL CO-OPERATION FOR INDUSTRIAL
DEVELOPMENT, RESTRUCTURING AND TRADE

Intergovernmental agreements as an
instrument of industrial co-operation

Note by the UNCTAD secretariat

The attached document was prepared by the UNIDO secretariat for submission to the Industrial Development Board and to the Committee on Manufactures. It is being submitted to the Trade and Development Board at its eighteenth session in accordance with the decision taken by the Board at the second part of its seventeenth session. 1/

1/ See TD/B/700, paragraph 31(a) and annex I, "Other decisions", section (b).



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INTERNATIONAL CO-OPERATION FOR INDUSTRIAL DEVELOPMENT, RESTRUCTURING AND TRADE

Intergovernmental agreements as an
instrument of industrial co-operation

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Introduction

1. Consultations have taken place between the secretariats of UNIDO and UNCTAD on international co-operation for industrial development, restructuring and trade. A joint report by the two secretariats on these consultations is submitted to the Board through the Permanent Committee at its present session.^{1/} The present note is the background document prepared by the UNIDO Secretariat to which reference is made in paragraph 6 of the joint report. The corresponding UNCTAD background document (TD/B/C.2/179) is being distributed to delegations of the Permanent Committee under the symbol ID/B/C.3/CRP.6.
2. The present note examines the ways in which the instrument of intergovernmental agreements might be used as a framework for international industrial co-operation. In order to avoid duplication with the content of the parallel UNCTAD document, the present note concentrates on the industrial rather than the trade aspects of such agreements.

Summary and conclusions

3. The conditions in which industrial co-operation has developed are evolving continuously. The intensified industrialization of the developing countries is responsible for a growing and significant part of the export of capital goods from developed countries. Further, there is a greater tendency to buy complete industrial plants or complexes rather than individual items of equipment. Moreover, such arrangements tend to include commercial obligations that extend beyond those associated with the sale of plant and equipment. These additional obligations may relate to transfer of technology, training, management assistance, guarantees in regard to performance of the plant, and marketing of some part of the output.
4. As a result of these changes, the need is evident to develop more sophisticated arrangements to cater for the more complex relations between the partners, relations that are due to extend over a longer time period and to cover a wider range of activities. Agreements are necessary in such relationships to protect the interests of all the parties and for a variety of reasons they must necessarily involve Governments.
5. In most developing countries, it is often the Government that undertakes the large industrial projects that require such long-term industrial co-operation agreements. No private enterprise in a developing country is likely to undertake obligations to a foreign partner of the type required in industrial projects without first obtaining from the Government something stronger than acquiescence. To deal with exchange control regulations, immigration laws, import restrictions etc., the enterprise will generally need positive government support. Developing countries expect a similar involvement on the part of Governments in developed countries when dealing with private enterprises in those countries.
6. Developing countries are interested in government framework agreements on industrial co-operation for two basic reasons: they seek stronger guarantees that industrial plants will perform in accordance with the supplier's undertakings; and they seek buy-back arrangements in the supplier's country to provide part of the market for the future output of the plant. Such buy-back arrangements are implicitly an additional performance guarantee because they ensure that if the products have been designed to international standards, the output of the plant will meet those standards.

^{1/} ID/B/C.3/64.

7. Industrial co-operation between the socialist countries of Eastern Europe and some developing countries as well as between those socialist countries and other developed countries is often regulated by intergovernmental agreements. There are fewer intergovernmental agreements relating to industry between developed market-economy countries and developing countries; most existing agreements of this kind are of a rather general nature, intended to create a climate of goodwill and confidence in which individual enterprises in the two countries concerned are encouraged to enter into industrial co-operation agreements for specific projects.

8. Governments already reinforce the provisions of industrial co-operation contracts concluded between enterprises in a number of ways. Bilateral agreements on investment protection and a multilateral treaty on the settlement of investment disputes^{2/} have been concluded between Governments. The Lomé Convention represented a novel initiative for increased industrial co-operation between the members of the European Economic Community (EEC) and the African, Caribbean and Pacific (ACP) countries. The financing of long-term industrial contracts is often assisted by the Governments of both the purchaser and the supplier of the necessary equipment. Furthermore, the co-operation of parastatal bodies and technical training institutes may be required for facilities that the enterprise cannot provide. For all these reasons, intergovernmental agreements are suitable instruments for industrial co-operation.

9. The above essentially industrial aspects of industrial collaboration agreements and the trade and related aspects of such arrangements discussed in the report prepared by the UNCTAD secretariat^{3/} need to be considered simultaneously. The Executive Director of UNIDO and the Secretary-General of UNCTAD accordingly propose that an ad hoc UNCTAD/UNIDO group of experts be jointly established, with terms and modalities as defined in paragraph 12 of document ID/B/C.3/64.

The changing context of industrial co-operation

10. The context in which industrial co-operation takes place between developing and developed countries has changed. A large and growing proportion of international trade in engineering products is now linked with the industrialization process in developing countries. The north-south flow of engineering products from industrial areas to developing countries exceeded \$75,000 million in 1976, equivalent to five times the level of the west-east trade flow of these products to socialist countries.^{4/} Engineering products are the largest single component of the imports of many developing countries. Moreover, developing countries have been the fastest growing market in recent years for exports of such products from developed countries.^{5/}

11. Another trend is that items of production equipment are purchased less and less in isolation and increasingly as part of an industrial plant or complex; trade is in complete plants

^{2/} The Convention on the Settlement of Investment Disputes between States and Nationals of other States entered into force on 14 October 1966. Disputes between States that have ratified this Convention may be referred to the International Centre for the Settlement of Investment Disputes (ICSID) in Washington D.C. By June 30, 1977, 67 States had ratified the Convention and are thus members of ICSID; five additional Governments had signed but not yet ratified the Convention. The annual report of ICSID provides details of its membership and affairs.

^{3/} ID/B/C.3/INF.21, also issued under the symbol TD/B/C.2/179.

^{4/} See the table in annex.

^{5/} See analysis of trade among groups of countries in International Trade 1976/77, General Agreement on Tariffs and Trade, Geneva 1977, table 7.

rather than machines. In the case of France, exports of complete industrial plants represented some 8 per cent, by value, of the exports of capital goods in 1971 and 1972; by 1975 and 1976, the proportion had increased to more than 20 per cent. Corresponding information relating to exports by other developed countries over a series of years is not immediately available. Further investigation would seem desirable with a view to analysing the trend according to exporting countries and areas of destination. Although this trend reflects the needs of the developing countries that buy industrial technology, it will also generally correspond to the interest of suppliers, for the following reasons. When a developing country purchases a complete industrial plant, it is usually buying a "package" which includes a manufacturing licence, process know-how, technical assistance, training facilities, project management, etc. In purchasing such packages, developing countries are looking for a total transfer of technology consisting not only of machinery and equipment but also of the technical knowledge to master the efficient organisation of industrial production.

12. Developing countries are looking, therefore, for stronger guarantees that the industrial plants will perform as well as the supplier promised in the contract. The pressure is for the foreign supplier to provide results, not just goods and/or services. This emphasis on performance and the corresponding guarantees has been prompted by many cases in which the quality, quantity, cost, etc. of output stipulated in the contract have not been achieved.^{6/} The consequences of non-achievement are considerably more costly to the developing country than the present generally accepted maximum penalty of 10 per cent of the value of the contract, since losses include not only the value that would have been added by the output lost, but also the foreign exchange expenditure incurred for the project, lost jobs and secondary effects in other sectors.^{7/}

13. An additional feature of these complex trade deals is the interest shown by many developing countries in securing export markets for part of the output as a means to help pay for industrial plants. This is a practice that has developed to a significant extent in east-west trade. In 1975 to 1976, 15 to 20 per cent of imports by the socialist countries of Eastern Europe from developed market-economy countries came under various compensation arrangements (reciprocal purchases, buy-back) and according to some estimates this proportion is expected to reach 30 to 40 per cent in 1980.^{8/} The practice has also developed to some extent in trade between Eastern Europe and the developing countries. These developments are facilitated by the involvement of government authorities on both sides.

14. When these more far-reaching technical and marketing obligations are contractually joined to the sale of industrial plants, industrial co-operation agreements become more complex and cover longer time periods. In certain sectors, such contracts have already been concluded for

^{6/} See "Draft resolution concerning the establishment of an insurance system for guaranteeing contracts concluded by the developing countries with enterprises from the developed countries" (submitted by the Group of 77 and Romania to the Second General Conference of UNIDO) ID/CNCP.3/L.9, and A/32/16, paras.176-178.

^{7/} This topic was recommended for further examination by the First Consultation Meeting on the Fertilizer Industry; the First Working Group Meeting on Contracts and Insurance for Fertilizer Plants, held in Vienna in February 1978, recommended that consequential losses resulting from defects in design, manufacturing etc. be covered by insurance provided by commercial sources, perhaps with some support from Governments (see draft report of the meeting, ID/WG.269/2).

^{8/} "Current counter-trade practices", Business International, Geneva, 1976.

a 10-year period with the possibility of extension. The trend has become clear in east-west industrial co-operation agreements; it is a trend that is desirable to promote when selling to developing countries, since their industrial infrastructure and industrial base are less well developed than in the socialist countries of Eastern Europe.

15. These changes in context will call for important changes in the scope and form of industrial co-operation arrangements in the future and consequently in the involvement of Governments in such arrangements.

The emerging scope and form of industrial co-operation

16. For a variety of reasons, many countries throughout the world seek to negotiate a trade counterpart when purchasing capital goods, particularly large industrial complexes, in the form of buy-back purchases. As already mentioned, the motives are often financial: the purchasing country is anxious to maintain equilibrium in its balance of trade or to limit its debts. They may be commercial: the purchasing body or country finds in such a compensation deal a convenient way of assuring the sale of all or part of its production, thereby overcoming its weaknesses in the area of marketing and also saving the cost of setting up a distribution network.

17. Yet again, the motives may be connected with national industrial policy: they may stem from a desire to put agricultural, mineral or energy resources to more profitable use, through processing - or sometimes simply to put the country's labour potential to productive use. This results in the establishment of large-capacity means of production, well beyond the needs of the national market and therefore deliberately export-oriented. A compensation deal in that case is a way of sharing the market. Motives may also depend on technical considerations regarding optimum size for a given installation and process technology; this leads to a capacity that exceeds the national need at the time. The motives may be a concern for security and for a guarantee of the satisfactory functioning of the installation acquired, which is better assured when the supplier is prepared to buy back the products. Finally, the motives may be related to the transfer of technology: the supplier who buys back goods is inspired to furnish up-to-date technologies.

18. Operations in which the transfer of technology is a crucial component must bring together, successively or simultaneously, a number of elements (industrial, financial, commercial, technical assistance, etc.). The growing complexity of commercial relations increases the number of parties involved, and also the time for which they are involved. Investments are becoming increasingly large and contracts cover periods that are often longer than 10 years. The size of these commitments presupposes government support by the country of origin of the supplier, primarily in the form of export credits of various kinds. The contracts also require, however, implicitly or explicitly, that trade should be "constructed". In the longer term, this means that policies of adjustment need to be devised to smooth the changes in industrial structure consequential to the changes in the trade pattern.

19. Alongside the typical forms of activity in developing countries of industrial companies based in the developed countries - undertaken through subsidiary companies or branches and through joint ventures - more complex operations are taking the stage, connected with the processes involved in the transfer of technology and embracing technical, financial and commercial functions. As has been stressed above, these new operations meet a need but, at

the same time, they reflect the existence of new relationships between the partners. In practice, the dividing line between the old forms and the new operations is blurred, if one looks closely into the full implications of both forms of organization.

20. In these industrial collaboration arrangements, the various functions may be grouped under two headings: production engineering and commercial exploitation. Production engineering is used here to mean an independent activity consisting of the design and construction of industrial complexes. Typically, it has a set of methods and structures that permit the mastery of the scientific, technical, economic and financial information needed for the design and construction of plant in a coherent production complex. Commercial exploitation functions include domestic and foreign trade, finance and credit, collection of market and other information, general organization of the arrangements.

21. Several factors have led to the emergence of production engineering companies. On the one hand, there is an exceptional international situation: many developing countries have a common desire to acquire advanced engineering - they wish to move fast in their industrialization and also to possess from the very beginning extremely modern industrial units. On the other hand, there is a trend towards specialization in certain functions that are essentially rather different: the development of manufacturing processes and technology, product design, the supply of production equipment, the provision of civil engineering work, training and marketing.

22. Because of the need to exercise all these functions abroad when a turn-key factory is being built in a developing country, production engineering has to maintain close relations with the other centres of activity of the industrial system: research and development, manufacture of production equipment, production know-how and the banking sector.

23. The requirements of international industrial co-operation are forcing production engineering companies and those concerned with commercial exploitation to work together with increasing frequency. The Japanese trading companies (sogo shosha) are the best-known examples of all these functions being exercised within a single corporate structure. In some other industrialized countries, formal association between the two types of company has taken place; in others, a number of recent private or public initiatives have gone in that direction.

24. In all these developments, the common factor is a growing link between industrial and commercial operations. As a consequence, various agents who until recently acted separately now become involved jointly and simultaneously. A further consequence has been a more distinct and explicit support by Governments of the arrangements for industrial co-operation.

25. The traditional forms of government assistance offered by developed countries - export credits or insurance of export credits - have been standardized and in the process have become less capable of adaptation to new needs and circumstances. The new forms of industrial co-operation mentioned above are reflected in new types of contract and lead to new relations between industry and commerce: they imply new forms of government participation because the guarantees and insurances required by developing countries to go beyond the mere support to exports which the export credit insurance bodies are authorized to provide.

26. This new trend in industrial co-operation, although it depends markedly on the activities of large companies, does not exclude participation by small- and medium-sized firms in the developed countries. These enterprises have techniques and know-how that may be of interest to many developing countries that are trying to build up an industrial structure. To be effective,

however, their activity must be supported by Governments, since generally they lack the necessary financial resources and knowledge of investment opportunities in the developing countries.

27. The Governments of developed market-economy countries already support international industrial co-operation contracts between enterprises in a number of ways. There are bilateral intergovernmental agreements on investment protection and a multilateral treaty has been concluded on the settlement of investment disputes. The provisions of the Lomé Convention include measures for increased industrial co-operation between the members of the EEC and the "associated" developing countries.

28. Industrial co-operation agreements between countries with centrally-planned economies and developing countries go some way to provide an appropriate framework for the new and more complex forms of industrial co-operation discussed above. Such agreements provide for the establishment of mixed commissions and sectoral groups to implement the industrial co-operation agreement and to settle any disputes that may arise. This topic is elaborated in the background paper prepared by UNCTAD. ^{2/}

The characteristics of industrial co-operation
that require government intervention

29. In developing countries industrial projects are of major importance to the national economy. The Government tends, therefore, to impose certain obligations on the local industrial enterprise as a matter of national economic policy. The training and employment of national personnel, the purchase within the country of an increasing proportion of the components of the product to be manufactured and the compensation of foreign currency expenditure incurred by the enterprise through export earnings are examples of such obligations. They have a direct bearing on the very nature of international industrial co-operation, including the obligations of the supplier of technology and the potential involvement of the Government of the country supplying the plant.

30. Modern industrial production processes are complex and therefore their transfer to developing countries requires a major effort from both recipient and supplier of equipment and related know-how. In the event of unsatisfactory performance, the adverse consequences can seriously retard the economic development of the developing country. The recipient country's Government should, therefore, be able to have recourse to the Government of the country of the supplying enterprise with a view to ensuring that the supplier fulfills his obligation to make the industrial plant perform as promised.

31. Action to guarantee satisfactory fulfillment of performance specifications in contracts has not been the subject of bilateral intergovernmental protocols to date. There is no reason, however, why these problems should not be settled within an agreed framework, bearing in mind the growing importance of the industrial projects established in developing countries through international co-operation.

32. The financing of long-term contracts often includes the involvement of the Governments of both the recipient and supplying country. Long-term credits are frequently guaranteed by the export credit insurance organization of the Government in the supplier's country. Payment

^{2/} See ID/B/C.3/CRP.6.

of this debt by the purchaser is often guaranteed by the Government or central bank in his country. Both Governments therefore have an interest in the stability of the new venture and hence in the effectiveness of the industrial co-operation agreement.

33. Industrial co-operation may require facilities that the enterprise in the developed country cannot itself supply, since they come within the competence of universities, technical training establishments and other public or parastatal bodies. The provision of such assistance as part of the contractual arrangements will be facilitated if an intergovernmental agreement is concluded, thus providing a better basis for enabling such requirements to be met.

34. Finally, when industrial co-operation contracts are of longer duration, they must cover changing conditions and requirements, price adjustments, etc. over lengthy periods of time. The involvement of Governments is often needed to contribute to the stability of such arrangements.

The need for a policy which builds up international trade through
intergovernmental industrial co-operation agreements

35. There is a growing consensus that the rules of international trade need to be modified and adapted in order to make it possible for the developing countries to become increasingly large exporters of industrial products and not so dependent as they are at present on exports of raw materials and a limited range of agricultural products. The role of Governments in bringing these changes about is mainly pragmatic and of great significance. Intergovernmental agreements on industrial co-operation are able to give direction to a series of initiatives which, taken together, can support a coherent global strategy that takes account of the new forms of industrial co-operation proposed in this paper for establishing production facilities in the developing countries.

36. The progressive opening of the markets of developed countries to certain products manufactured in the developing countries appears to be an essential concomitant to a new international division of labour. It assumes the application of a suitable industrial policy by the developed countries. Such a policy will not always be easy to define, precisely because the developing countries will become increasingly capable of producing for export a wide range of industrial goods. It will often require a change of direction in the industrial activities of the developed countries. Many of these countries have accepted the need for a meaningful industrial co-operation with the developing countries but face difficulties in implementing a new policy because the adjustments required need time to be accepted by all the parties involved.

The role of UNCTAD and UNIDO in promoting intergovernmental
agreements on industrial co-operation

37. The considerations that are discussed in the present document and the parallel background paper prepared by the UNCTAD secretariat^{10/} lead to the conclusion that the industrial and trade aspects of intergovernmental agreements on industrial co-operation must be considered in an integrated way by the United Nations system. The Executive Director of UNIDO and the Secretary-General of UNCTAD therefore propose that an ad hoc UNCTAD/UNIDO group of experts be jointly established, with terms of reference and modalities as defined in paragraph 12 of document ID/B/C.3/64.

10/ See ID/B/C.3/CRP.6.

ANNEX

EXPORTS OF ENGINEERING PRODUCTS BY AREA OF DESTINATION

Table 1. From industrial areas in 1976

(in billions of US dollars f.o.b.)^{a/}

	World	Developing countries			Eastern trading area	Industrial areas
		Oil-exporting	Others	Total		
Machinery for specialized industries	71.0	10.0	13.0	23.0	7.0	38.4
Office and telecommunications equipment	23.5	1.9	4.3	6.2	0.4	16.0
Road and motor vehicles	64.6	7.5	6.0	13.5	0.8	47.9
Other machinery and transport equipment	90.5	12.5	15.0	27.5	4.2	56.0
Household equipment	20.4	1.7	2.6	4.3	0.2	15.2
Total engineering products	270.0	33.6	40.9	74.5	12.6	173.5

Table 2. From eastern trading area in 1975

(in billions of US dollars f.o.b.)^{a/}

	World	Developing countries			Eastern trading area	Industrial areas
		Oil-exporting	Others	Total		
Machinery for specialized industries	14.03	0.52	0.95	1.47	11.65	0.91
Office and telecommunications equipment	2.00	0.02	0.02	0.04	1.86	0.10
Road and motor vehicles	3.55	0.04	0.38	0.42	2.90	0.23
Other machinery and transport equipment	9.67	0.44	0.82	1.26	7.49	0.91
Household equipment	0.90	0.06	0.10	0.16	0.57	0.16
Total engineering products	30.15	1.08	2.27	3.35	24.47	2.31

^{a/} A "billion" equals 1,000 million.Source: International Trade 1976/77, General Agreement on Tariffs and Trade, Geneva 1977, Table 7.Definitions of areas:

Industrial areas:	Western Europe (the European Communities, the European Free Trade Area, Gibraltar, Greece, Malta, Spain, Turkey, Yugoslavia and countries n.e.s.), Canada, the United States of America and Japan.
Oil-exporting developing countries:	Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libyan Arab Jamahiriya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.
Eastern trading area:	Albania, Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland, Romania, USSR, China, Mongolia, Democratic People's Republic of Korea and Viet Nam.
World:	All areas and countries shown, together with Australia, New Zealand and South Africa.

Definition of engineering products in terms of the SITC, Revised: Section 7, divisions 69 and 86 minus groups 862 and 863, and subgroup 891.1.



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Page 7, paragraph 25, penultimate line

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